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March 16, 2010

Research Update:

S&PCORRECT: Espirito Santo Centrais Eletricas S.A. Upgraded To 'BB' From 'BB-', Off CreditWatch

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(**Editor's Note:** In the article published earlier today, the outlook on EDP - Energias de Portugal, S.A. in the fifth paragraph was incorrect. A corrected version follows.)

Overview

- Brazilian electric utility Espirito Santo Centrais Eletricas S.A. (Escelsa) has posted strong cash generation and improved credit metrics in 2009.
- We have raised the ratings on Escelsa, to 'BB' from 'BB-' on the global scale and to 'brAA' from 'brA+' on the Brazilian National Scale, and removed them from CreditWatch positive.
- The outlook on the corporate credit ratings is stable, reflecting our expectation that the company will maintain steady financial metrics by managing its existing debt and capital expenditures needs, while distributing dividends to its holding company.

Rating Action

On March 16, 2010, Standard & Poor's Ratings Services raised its ratings on Escelsa to 'BB' from 'BB-' on the global scale and to 'brAA' from 'brA+' on the Brazilian National Scale. At the same time, we removed the ratings from CreditWatch with positive implications. The outlook on the corporate credit rating on both scales is stable. The upgrade reflects the company's strong cash generation and improved credit metrics in 2009, despite the global recession that caused lower consumption in the industrial segment in Escelsa's concession area.

Rationale

The company's fair business profile reflects the benefits from an exclusive concession to distribute electricity in most of Espírito Santo state; its total electricity losses (15.5% in 2009) that have increased in the past few years and are higher than those of Escelsa's peers; adequate operating statistics (outage frequency and outage duration); and the company's exposure to the Brazilian electric sector's regulatory framework (which has shown a positive track record during the past six years). The company's concession area consists of 70 municipalities with most of its demand fairly distributed among residential, commercial, and industrial segments.

We assess Escelsa's financial risk profile as significant that reflects the company's steady financial performance with adequate cash flow protection measures due to its efforts to improve its debt amortization schedule, and the benefits of belonging to EDP Energias do Brasil Group, which create operating synergies. At the same time, it reflects the company's challenges to meet significant debenture amortization until 2014 and its capital expenditures needs, while presenting relevant dividend distribution for its holding company, EDP Energias do Brasil (not rated).

Despite the global recession that caused lower consumption in the industrial segment in Escelsa's concession area in 2009 (9.5% reduction in captive industrial demand, compared with 2008), company's other segments experienced higher demand, resulting in a 2.5% increase in electricity distribution in 2009. Along with tariff increases in August 2008 and August 2009, the company's revenue rose 11.8% in 2009. Escelsa's EBITDA margin remained stable, at 22.1% in 2009, compared with 22.4% in 2008.

Standard & Poor's expects Escelsa's credit metrics to be stable in 2010, as a result of expected captive market growth and recovery of industrial electricity demand to the levels prior to the global economic crisis, balanced by the August 2010 tariff revision that can result in tariff reduction, as occurred in the past tariff revisions. We expect the company will continue to manage its liabilities, preserving satisfactory amounts of cash holdings to deal with its debenture amortization, while distributing dividends to its holding company. Total debt to EBITDA and FFO to total debt are expected to be near 2.5x and above 35%, respectively, in the next few years.

Escelsa is an electric utility that holds exclusive concession rights for power distribution in roughly 90% of the municipalities in the State of Espírito Santo. In 2009, Escelsa distributed 4,888 gigawatt-hours of electricity to more than 1.1 million consumers. EDP - Energias de Portugal S.A. (A-/Negative/A-2) controls 64.8% of EDP Energias do Brasil, which is a holding company that controls one other electric distribution utility and one electric power commercialization unit. EDP Energias do Brasil also has stakes in several electric power generation assets (totaling 1,738 MW of installed capacity).

Liquidity

Escelsa's liquidity is adequate. As of December 2009, Escelsa had short-term debt of R$145.9 million and R$108 million in cash holdings. Short-term debt is basically made up of current portion of long-term debts. We believe Escelsa's short-term debt can be dealt with its cash generation and cash reserves, while the company should continue to finance its capital expenditures needs with long-term debt, such as BNDES loans, as the company did in 2009. For 2010, we expect the company to generate free operating cash flow of about R$50 million.

Outlook

The stable outlook reflects our expectation that Escelsa will maintain steady financial metrics by managing its existing debt and capital expenditures needs, while distributing dividends to its holding company. We expect Escelsa to post FFO to total debt above 35%, total debt to EBITDA about 2.5x, and total debt to total capitalization near 50%, even considering potentially higher dividend distribution. A positive trend for the ratings would come from improvements in company's level of electricity losses coupled with higher-than-expected financial metrics on a consistent basis, such as total debt to EBITDA near 2x and FFO to total debt above 40%. A negative pressure on the ratings would emerge if Escelsa fails to maintain adequate cash generation to meet its debenture amortizations, if there is a steep decline in electricity consumption in its concession area with a strong impact on its credit metrics, posting ratios such as FFO to total debt below 30% and total debt to EBITDA near 3x.

Related Criteria And Research

"2008 Corporate Criteria: Analytical Methodology," April 15, 2008.
"Criteria Methodology: Business Risk/Financial Risk Matrix Expanded," May 27, 2009.

Ratings List

Upgraded; CreditWatch/Outlook Action

	To	From
Espirito Santo Centrais Eletricas S.A.		
Corporate Credit Rating		
Foreign Currency	BB/Stable/--	BB-/Watch Pos/--
Local Currency	brAA/Stable/--	brA+/Watch Pos/--
Espirito Santo Centrais Eletricas S.A.		
Senior Unsecured	brAA	brA+/Watch Pos

Complete ratings information is available to RatingsDirect on the Global Credit Portal subscribers at www.globalcreditportal.com and RatingsDirect subscribers at www.ratingsdirect.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.
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